



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

MAR 21 1974

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The Honorable
The Secretary of Defense

Dear Mr. Secretary:

DOD policy, contained in DOD Directive 7410.4, requires that significant costs of maintaining unutilized and underutilized mobilization-essential plant and equipment at industrial fund activities be identified and separately funded.

DOD reported to the Congress in fiscal year 1972 that industrial fund activities were separately funded for about \$10.6 million for various functions in support of reserve industrial capacity. Only \$2.7 million of these funds were provided to maintain unutilized and underutilized plant and equipment.

Since the peak of the Vietnam hostilities, many industrial fund activities have had decreased workloads resulting in increased amounts of unutilized and underutilized plant and equipment. However, industrial fund managers are still responsible for such plant and equipment to the extent it is needed for mobilization preparedness.

In view of the reduced mission workload, continuing mobilization requirements, and small amount of costs reported for maintaining unutilized and underutilized plant and equipment, we reviewed the manner in which these costs were being computed, reported, budgeted for, and funded by 45 major Army and Navy industrial fund activities.

SCOPE OF REVIEW

We made our review at selected Army and Navy commands, including the Army Materiel Command, Chief of Naval Material, Naval Ordnance Systems Command, Naval Ship Systems Command, and Naval Air Systems Command. At these commands we reviewed pertinent financial data relating to 45 industrial fund activities. The acquisition value of plant and equipment at the 45 activities was about \$3.7 billion of a total of \$7.5 billion at Army and Navy industrial fund activities in fiscal year 1972.

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We did not review Air Force industrial fund activities because preliminary information indicated that plant and equipment were fully utilized at those activities where such assets were significant.

COSTS REPORTED BY INDUSTRIAL FUND ACTIVITIES

Only 18 of the 45 activities, with plant and equipment valued at \$1.6 billion, reported the costs of maintaining unutilized and underutilized facilities to their commands. The costs reported totaled \$73.9 million for fiscal year 1972. About \$71.5 million of these costs were not separately funded but were included in the operating costs of the activities and passed on to their customers.

At the six Army Materiel Command activities reporting, costs not separately funded and charged to customers amounted to \$22.9 million. This represented 13 percent of total overhead and increased the selling prices by 6 percent. For the 12 Naval Ordnance Command activities which reported, these costs totaled \$48.6 million, representing about 29 percent of total overhead and inflated selling prices by about 10 percent.

GAO ESTIMATES OF UNDERUTILIZED CAPACITY

The remaining 27 activities, with plant and equipment valued at \$2.1 billion, reported little or no cost data. On the basis of records available at the command level and by using fiscal year 1973 data where fiscal year 1972 data was not available, we estimate that underutilized capacity at these 27 activities averaged 34 percent. Data was not available to estimate the cost of maintaining this underutilized capacity because of the lack of DOD guidelines. In view of the extent of underutilized capacity at these activities, however, it appears that such costs would be significant.

ADVERSE EFFECTS OF NOT ADEQUATELY IMPLEMENTING DOD POLICY

We believe that, because the costs of maintaining unutilized and underutilized mobilization-essential capacity are not adequately identified, reported, and separately funded:

- The Congress and DOD are not fully aware of the costs of maintaining unutilized and underutilized plant and equipment for mobilization purposes at industrial fund activities.
- Industrial fund managers and their commands are not able to evaluate actual costs of providing customers with the products and services requested.
- Industrial fund customers are not receiving accurate billings, thus inflating the costs of their operating programs and, possibly, adversely affecting their decisions regarding selection of Government versus commercial supply sources.

NEED FOR POLICY IMPLEMENTATION GUIDANCE

We believe that the cause of the above conditions was the lack of instructions and procedures for implementing DOD policy. For example, DOD, the Army, and the Navy have not issued guidelines for determining the costs of maintaining unutilized and underutilized plant and equipment. Only the Naval Ordnance Systems Command had issued guidelines to its activities for computing and reporting these costs. The six Army Materiel Command activities which submitted data developed their own methods for determining costs. As a result, computation methods differed. Therefore, to insure that costs reported are complete and uniform, policy implementation guidance should include procedures for identifying and quantifying these costs.

CONCLUSIONS AND RECOMMENDATIONS

We believe that the costs of maintaining unutilized and underutilized capacity are significant and that the failure to fully report these costs and the inconsistencies in computing the data which was reported were caused primarily by the lack of procedures to be used for their determination.

Identifying and separately funding the costs of maintaining a mobilization readiness base would improve the Congress' and DOD's visibility for such costs and would also prevent the programs of industrial fund customers from being charged for costs not related to supporting those programs.

To implement DOD policy, industrial fund activities should be given detailed instructions for computing such costs and reporting them to higher commands. The commands, in turn, should be required to budget for these costs and to request appropriate funding.

We therefore recommend that the Secretary of Defense:

- Issue guidelines for computing, reporting, budgeting, and funding the costs of maintaining unutilized and underutilized mobilization-essential plant and equipment at industrial fund activities.
- Require the military services to issue comprehensive implementing instructions and to separately budget for and fund such costs.
- Require appropriate DOD internal audit organizations to review the implementation of DOD and service policies and instructions during scheduled audits of command and industrial fund activities.

AGENCY COMMENTS AND ACTIONS

We discussed the matters in this report with the Office of the Secretary of Defense (OSD) and the military departments, and they generally agreed

with our findings and conclusions. According to OSD officials, they separately fund the maintenance of unutilized and underutilized mobilization-essential capacity at the Military Traffic Management and Terminal Service, which was not one of the 45 industrial fund activities we reviewed.

OSD officials agreed in principle with our recommendations. They stated that OSD would emphasize to DOD components the need to implement DOD policy requiring that the cost of maintaining unutilized and underutilized mobilization-essential capacity be identified and separately funded. Further, OSD officials said that DOD would make a study to determine and resolve any problems impeding policy implementation.

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We shall appreciate being advised of the results of the above-mentioned study and of any actions taken on the matters discussed in this report.

We are sending copies of this report today to the Chairmen of the House and Senate Committees on Government Operations, Appropriations, and Armed Services; the Secretaries of the Army, Navy, and Air Force; the Director, Office of Management and Budget; and the Administrator, General Services Administration.

Sincerely yours,



D. L. Scantlebury
Director